File

Supreme Court of the United States

53

CONNECTICUT [illegible]

Petitioner,

vs.

HOWARD [illegible] PALMER, JAMES [illegible] DOOM and HENRY P. SAWYER, As Executors of the Estate of THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

GEORGE W. MARTIN,

Counsel for Petitioner.

[illegible]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. .....

CONNECTICUT RAILWAY AND LIGHTING COMPANY,
Petitioner,

AGAINST

HOWARD S. PALMER, JAMES LEE LOOMIS and HENRY B. SAWYER, as Trustees of the property of The New York, New Haven and Hartford Railroad Company, Debtor,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE CHIEF JUSTICE OF THE UNITED STATES AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Connecticut Railway and Lighting Company, a corporation organized under the laws of

Connecticut, prays that a writ of certiorari issue to review the decision of the United States Circuit Court of Appeals for the Second Circuit, in this case, so far as said decision affirms a decree of the District Court for Connecticut denying to your petitioner any damages, as landlord to the debtor, on account of injury resulting from the rejection of its unexpired lease subsequent to petition filed in proceedings under § 77 of the Bankruptcy Act, except damages already accrued and past at the time of the hearing on your petitioner's claim.

Summary Statement of Matter

On December 19, 1906, your petitioner (C. R. & L.), as landlord, leased certain public utility properties to the New Haven Railroad (then known as The Consolidated Railway Company) for 999 years at a stipulated annual rental (after August 1, 1914,) of $1,400,000. (R. 101-129).

After February 28, 1910, the "gas and electric properties" were assigned by the New Haven, for the balance of the term, to a solvent assignee at one-quarter of the rental reserved by the head lease. These properties and this quarter of the rent are not relevant here. The instant case is concerned only with the "electric railway properties", which were thereafter subjected to three-quarters of the rent, amounting annually to $1,049,563.50. The New Haven made no default under the lease till 1935.

On October 23, 1935, the New Haven filed its petition under § 77 of the Bankruptcy Act (R. 4). The petition was approved (R. 15) and the New Haven was authorized by the Court to reject the lease (R. 19).

On December 18, 1935, the New Haven and its Trustees reported to the District Court that they rejected the lease (R. 48).

On April 30, 1936, your petitioner filed its claim for unpaid rent under the lease to petition filed and for damages on account of rejection.

On June 30, 1937, the hearing on the claim commenced in the District Court.

Rulings Below

1.) C. R. & L. claimed for rent accrued to petition filed $388,282.83. The District Court allowed for this $332,330.88. The Circuit Court of Appeals allowed $388,282.13. (R. 1364).

2.) C. R. & L. claimed damages of $2,057,862.02 for deficiencies in the property returned. The District Court allowed $173,537.35. The Circuit Court of Appeals affirmed (R. 1365).

3.) C. R. & L. claimed $23,190,314.73 as damages for the rejection of the lease.[1]

The District Court allowed as damages:

a.) For the period from petition filed (Oct. 23, 1935) to rejection (Dec. 18, 1935)—nothing.

b.) For the period from rejection to hearing on the claim (June 30, 1937) $1,263,412.92.

[1] That is, the difference between the present worth of rent and of rental value for the balance of the term of the lease, liquidated by discounting at 4%.

c.) For the period from hearing to the end of the term of the lease—nothing.[2]

The Circuit Court of Appeals allowed as damages:

a.) For the period from petition filed to rejection—nothing.

b.) For the period from rejection to hearing on the claim $1,424,457.13.

c.) For the period from hearing on the claim to the end of the term of the lease—nothing.

Questions Presented

1.) Is a landlord under an unexpired lease rejected in proceedings under § 77[3] a creditor entitled to prove for damages measured by the difference between the present worth of rent and rental value for the balance of the term?

2.) When Congress provided in § 77 that a landlord under a rejected lease was "a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings", did Congress intend to limit the landlord's claim to damages past at hearing?

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[2] The Court, however, gave C. R. & L. the right to apply for a later supplemental hearing to liquidate any damage which might have accrued in the interim (R. 338); but it must be *past* damage. The Circuit Court of Appeals approved the proposed procedure.

[3] The Statute is set forth in the annexed Brief.

3.) If the landlord's claim under the lease is discharged by rejection, must not his claim for damages accruing after hearing "be admitted to participation on an equitable basis with other claims in shaping the reorganization and in distribution of that which is to go to creditors pursuant to any plan adopted"?[4]

4.) If "actual damage" as used in § 77 means "past damage" (R. 335), is there a compliance with the constitutional requirement that if claims for "future damage" are to be discharged they must be provable at least within the limits of some reasonable formula?

Reasons Relied on for Allowance of Writ

The decision of the Circuit Court of Appeals affirms a judgment of the District Court construing for the first time the words of § 77 of the Bankruptcy Act as applied to a landlord's claim. These words are: "Any person injured by such non-adoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings."

The District Court (Hincks, *J.*) held that "principles obtaining in equity proceedings" had nothing to do with the amount or provability of damages (R. 332). He further held that "actual damage" must mean damage accrued at the time of the hearing (R. 335), to the exclu-

[4] *Kuehner* v. *Irving Trust Co.*, 299 U. S. 445, at 453.

sion of all "future" damages not then accrued, *i. e.*, sums not yet due under the lease.

The District Court, accordingly, held that the Statute precluded him from allowing "future" damages (R. 336) —*i. e.*, for injury due to loss of the balance of the term after hearing—but directed a supplemental hearing be held before final adoption of a plan of reorganization, at which additional damages accrued to that date might be proved.

The Circuit Court of Appeals affirmed this disposition (Opinion by Manton, *J.*) but without discussion of the principles involved (R. 1363). The Court says:

> "The court properly declined to allow under this claim for the breach of any future damages. But, where loss of rent is abundantly proved up to the time of repossession of the property, it is of sufficient certainty to be allowed. Therefore, the 'actual damage or injury' means that of the past. A long lease such as for 999 years adds to the reasonableness of this application of the statute. Congress intended by the phrase of the statute to end controversies as to future damages involved in long lease, and it did so by making such claims under a lease provable and so dischargeable, thus disposing of them." (R. 1363-4).

It is respectfully suggested that this is difficult to follow. The first sentence seems to affirm the District Court.

The second sentence speaks of "repossession of the property". § 77B has such a reference; but not § 77.

The District Court took proof of damages to the time of hearing—not of repossession.

The fourth sentence speaks of the length of this particular lease as affecting the construction of the Statute.

The fifth sentence we entirely agree with; but your petitioner's claim for "future" damages has been held not provable.

It is supposed that 30% of the railroad mileage in the United States is now in process of reorganization in the Federal Courts. It is inevitable that claims under executory contracts and unexpired leases will be numerous. Thus far the courts have passed on only two: the instant case, and the claim of Old Colony Railroad Company under a 99-year lease with the New Haven. The Old Colony claim is about two months behind this one, and was disposed of by the District Court of Connecticut on the authority of the instant case. It is now on the calendar in the Circuit Court of Appeals for the Second Circuit, but has not yet been heard.

It is of the first importance that the question of the rights of executory obligees and landlords be passed on by this Court, since it is evident the decision construing § 77 will profoundly affect the pending reorganizations, the proceedings before the Interstate Commerce Commission, and projected legislation. The amounts of such claims are large; and the public, not only from the point of view of the carriers but also by reason of the investments of the life insurance companies and savings banks, has a great interest at stake.

The Statute as interpreted below overturns established legal principles under which the claims of executory creditors could not be discharged in the exercise of power under the Bankruptcy Clause, without provision for admitting them to participation on an equitable basis in the debtor's assets; it denies to landlords the right to damages for loss of their leases, which Congress attempted to give them in § 77, and leaves many of them in a worse plight than they would have been before the enactment of § 77; it provides that justice shall be commensurate with the law's delay; and it violates the Fifth Amendment.

WHEREFORE, your petitioner prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit, to the end that this case may be reviewed by this Court.

CONNECTICUT RAILWAY AND LIGHTING COMPANY,
By: GEORGE W. MARTIN
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion of the District Court (per Hincks, *J.*) appears at pages 313-364 of the Record, and is not officially reported. The opinion of the Circuit Court of Appeals (per Manton, *J.*) appears at pages 1361-1366 of the Record, and is not yet officially reported.

Jurisdiction

Jurisdiction to issue the writ is vested in this Court by § 240 (a) of the Judicial Code, as amended by the Act of February 25, 1925. The order for the mandate was entered on March 14, 1938.

Statement of the Case

The facts, the rulings of the courts below, and the questions presented are set forth in the foregoing petition.

Statute Involved

§ 77 of the Bankruptcy Act, (11 U. S. C. § 205 (b); 49 Stat. 911, Aug. 27, 1935) provides:

> "§ 77. Reorganization of Railroads * * * (b) * * * The term 'creditors' shall include, for all purposes of this section, all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including

the holder of a claim under a contract executory in whole or in part including an unexpired lease. * * * The term 'claims' includes debts * * * or other interests of whatever character. * * *

"In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. * * *

(f) * * *. "The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention."

Specification of Errors

The Circuit Court of Appeals erred in holding:

1.) That the amount of the landlord's provable claim for damages is *not* "the difference between the rental

value of the remainder of the term and the rent reserved, both discounted to present worth",[5] but is the amount of damages past at hearing on the claim.

2.) That the law's delay between rejection of the lease and final hearing on the claim constitutes an "equitable basis"[6] for measuring the participation of the landlord in the distribution of assets.

3.) That § 77 limits the provable claim of a landlord to damages past at hearing, although his claim for loss of future rents is discharged.

Summary of Argument

Your petitioner was landlord of the New Haven Railroad. The lease was disaffirmed by the New Haven's Trustees pursuant to authority of the bankruptcy court. Your petitioner then claimed as damages for the loss of the lease "the difference between the rental value of the remainder of the term and the rent reserved, both discounted to present worth," viz.: $23,190,314.73.

A hearing was had on the claim in the District Court (Hincks, *J.*) on which the Court ruled correctly: that under § 77, as was decided with respect to § 77B, a lessor has a provable claim "for injury due to the rejection of his lease whether the instrument contained a covenant of indemnity or not, and even though the lease be terminated subsequent to its rejection in the bankruptcy proceedings"

[5] *City Bank Co.* v. *Irving Trust Co.*, 299 U. S. at 443.

[6] *Kuehner* v. *Irving Trust Co.*, 299 U. S. at 453.

(R. 329); that the provision of § 77 that a claim shall be provable "to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings" does not modify the right created or recognized, but modifies "only the remedy; only the damages provable under the right" (R. 330); that the phrase "the principles obtaining in equity proceedings" furnishes no ground for excluding what he calls "future damages", for in equity receiverships, as in bankruptcy, if the lease contains a proper covenant, "it is abundantly clear that such damages, when proved with sufficient certainty, must be allowed" (R. 332-333).

The District Court then proceeded to construe the word "actual", in the phrase "the actual damage or injury", as requiring that the damage must have accrued from past defaults (R. 334-335) "to the exclusion of all 'future' damages not yet accrued"; and he said: "While I feel constrained to hold that by statute I am precluded from allowing 'future' damages, I am still free, indeed impelled, so to direct these proceedings that the rigid limitation of the statute, while serving its purpose, may yet interfere as little as possible with substantial justice" (R. 336).

So he allowed only damages past at the date of hearing.

The rationale of the opinion of the Circuit Court of Appeals (per Manton, *J.*; A. N. Hand, *J.* concurring in result,) is not susceptible of analysis (R. 1363).

It is respectfully submitted:

The history of the statute lends no support to the construction below.

The construction below is at variance with the Court's decision in the City Bank case.

The term "actual damages" in § 77 means "compensatory damages"—not "past damages".

POINT I.

The History of § 77 indicates no Intention to impose a Time-Limitation as the measure of Damages.

§ 77 was originally enacted on March 3, 1933. It provided that the term "creditors" should include all holders of claims against the debtor, "including claim for future rent, whether or not such claims, interests, or securities would otherwise constitute provable claims under this Act".

In 1935 § 77 was amended. The amendatory bill, H. R. 6249, in its original draft, provided that in case an executory contract or unexpired lease were rejected, "any person injured by such non-adoption or rejection shall, for all purposes of this section, be deemed to be a creditor to the extent of such damage or injury" without further limitation. "Thus," says the District Court (R. 334), "the original text of the bill was admirably worded to accomplish the allowance of future damages."

The final text of the amendment (p. 10, *supra*) differs from this, principally by substituting "actual damage" for "such damage", and by adding the cryptic phrase, "determined in accordance with principles obtaining in equity proceedings".

Apparently, all the commentators[1] and courts who have considered the matter (with the possible exception of Judge Manton) conclude that the final phrase has nothing to do with the amount of damages. It is the words "actual damage" which led the District Court to conclude that he was bound by a rigid rule precluding proof of claims for loss of future rents. If the desire of Congress was to leave the final determination to the courts, this ruling has defeated such intention.

Furthermore, the fact that categorical limitations on future rent claims were included in § 63 and § 77B, but not in § 77, is as indicative of an intent to allow such claims in full as to place some limitation on them; and the preliminary drafts clearly indicate that no limitation was contemplated. Neither on the testimony before the Judiciary Committee, nor in the reports of the bill to Congress, nor in the discussion on the floor, is there any suggestion that a limitation was intended.

The history of the legislation, therefore, furnishes no indication that any change of substance was intended by the final amendment.

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[1] Friendly, *Amendment of R. R. Reorganization Act*, 36 Col. Law Rev., 27, 50-52; *Lessors' Claims under § 77*, 47 Yale Law Jour., 272-277; (R. 332-333); Report Fed. Coordinator of Transp. dated Jan. 21, 1935 (House Doc. No. 89); 79 Cong. Rec. 13298, 13764 (1935).

POINT II.

This Court has held the "Injury" from Rejection to be the Loss of Future Rents.

§ 77B of the Bankruptcy Act says: "any person injured by such rejection shall * * * be deemed to be a creditor".

§ 77 says: "any person injured by such nonadoption or rejection shall * * * be deemed to be a creditor".

This Court has said, with regard to §77 B: "the purpose is clearly to give a landlord a provable claim for injury due to the rejection of his lease, whether the instrument contains a covenant of indemnity or not", (299 U. S. 441).

The same conclusion is obviously true of § 77.

This Court has also stated: "The amount of the landlord's claim for the loss of his lease necessarily is the difference between the rental value of the remainder of the term and the rent reserved, both discounted to present worth", (299 U. S. 443).

This method of liquidation is "familiar and fair".

Wm. Filene's Sons Co. v. *Weed*, 245 U. S. 597, 602.

It is recognized in allowing claims under § 77B.

City Bank Farmers Trust Co. v. *Irving Trust Co.*, 299 U. S. 433, 443.

Certainly no court has allowed a claim under § 77B for damages which were not "actual". So that damages thus calculated must be actual, even though Congress has provided for a three-year limitation on the amount.

But in the instant case, the loss of benefits under the lease accruing after date of hearing was held no measure of the landlord's claim for any purpose. It was not that recovery for this loss was limited by some reasonable commutation. It was denied and discharged without recognition.

In effect, therefore, no claim under the Statute was allowed for injury resulting from rejection; for proof of any previously made and lawful claim that matured within a reasonable time before distribution could be made was always allowed in equity receiverships. (*Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597, 602). The last state of landlords is thus worse than the first. No longer may they keep alive their claim by refusing to reenter. No longer may they prove for anticipatory breach under a covenant of indemnity.

Surely this was not the result intended by Congress when it undertook "to supply the omission of the Act of 1898 [*i. e.*, a remedy for the loss of future rents] and to create a claim provable in a reorganization proceeding for injury due to a trustee's rejection" (299 U. S. 442).

POINT III.

In § 77 "Actual Damages" means "Compensatory Damages"—not "Past Damages".

As set forth above, § 77 as enacted in 1933, defined a creditor, *inter alia*, as the holder of a "claim for future rent". When § 77 was amended in 1935, it is reasonable to suppose that this phrase gave pause to the draftsman. He would say: "Not the future rent—only the damages, only the net loss; the difference between the present worth of the rent and of rental value for the balance of the term * * *".

The quick way to say this is "actual damage". "The peculiar and unfortunate status of landlords' claims under the Bankruptcy Act of 1898" (299 U. S. 453) was known, and "in framing the reorganization statute Congress obviously attempted to award landlords an equitable share in the debtor's assets as, in justice, it was bound to do since the purpose was to discharge the debtor from liability to future suits based upon the lease" (*id.*). Furthermore, "actual damage" had been judicially held to mean the difference between the stipulated rent and the sum for which premises were leased to other parties (*Addieg* v. *Tull*, 187 Fed. 101, 103); and at the same time, so far as known, no court has ever before construed this phrase as eliminating consideration of the future consequences of the act upon which liability is based.

See:

In re N. Y., N. H. & H. R. R., 92 Fed. (2) 428.
S. E. Hendricks Co. v. *Thomas Pub. Co.*, 242 Fed. 37.
Samuels v. *E. F. Drew & Co.*, 292 Fed. 734, 738.
Black's Law Dictionary, (2nd Ed.), p. 315.

If Congress, by using the word "actual" sought to impose any further limitation upon a lessor's claim than the one here urged, then it certainly chose language which is poorly adapted to this purpose. Where such limitations are found, they are clearly stated, as in § 63(a) and in § 77B(b), and contain specific references to surrender of the property as the operative date. Moreover, if the limitation prescribed below was intended when § 77 was amended in 1935, there was need for clarity; for in that event Congress exactly reversed the policy it had adopted when § 77 was first enacted.

The reason for the three-year limitation in § 77B and the absence of any such limitation in § 77 is found in the subject matter of the two sections. § 77B usually involves business properties, which a landlord may relet, thus mitigating his loss. It is desirable to have a rule of thumb in such cases which will work substantial justice without the necessity of long and elaborate proof. In the case of railroads, however, usually the lessor cannot relet except to the reorganized tenant, and this obviously is a complicated matter in which the non-operating landlord is at a disadvantage. Moreover, to a great extent,

every railroad lease is unique; hence no rough and ready rule of limitation would have been practicable. The matter was accordingly left to be adjusted by the application of the usual measure of damages to the circumstances of each individual case.

LAST POINT.

As construed Below § 77 is unconstitutional.

The court below has allowed only damages past at hearing. In a pie powder court this would mean zero. In any other court it results in the recovery being proportionate to the law's delay. In any event, it here results in the destruction of the tenant's liability for future rents without any compensation therefor. This is beyond the power of Congress under the Bankruptcy Clause, and violative of the Fifth Amendment.

If claims "for rent to accrue under a lease * * * are to be discharged they must be made provable, for they cannot be destroyed".

City Bank Co. v. *Irving Trust Co.*, 299 U. S., at 439.

Kuehner v. *Irving Trust Co.*, 299 U. S., at 453.

Respectfully submitted,

GEORGE W. MARTIN,
Counsel for Petitioner.